RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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April 1, 1992 **LETTER 1092**

1992: In my early January Letter I opined that 1992 would be characterized as the "The Year of the Surprises," and so far that's been the case. First, we had the smash of the Japanese Nikkei below 20,000. Then we were treated to "the interest rate surprise," the rise in the long US Treasury bond yield to 8% (and fixed mortgage rates to above 9%). I think the third surprise is China, where Marx and Mao are rapidly losing out to Adam Smith (I'm talking capitalism).

What's next? Evidently, a world slowdown. European and world markets are now quietly sinking into recession, and this is impacting on US exports. In 1990 the total volume of world trade increased by 13.5% over 1989. In 1991 the increase dropped to 1.5%. The continuing trade slump is setting off an international battle for exports. This is important -- the export sector of the US economy is bigger than US housing and auto sales taken together. In fact, exports have been carrying the US economy. So if exports slump, mmmm.

One of the reasons for the dramatic slide in US consumer confidence is the following realization -- for the first time, massive federal deficits have prevented the government from spending us out of recession. The fact is that today's politicians have finally been mesmerized by the gigantic budget gap (over $400 billion this year). As a result, all spending has to be "revenue neutral." In other words, an increase in spending here has to be counter-balanced with a cut there. This has stymied the politicians.

Coming up: the US government will have to borrow the unbelievable sum of $630 billion this year. This will serve to finance this year's $400 billion deficit plus a roll-over of previously issued debt as well as covering federally sponsored loans. Now get this: that $630 billion is equal to TWICE the total savings that the US economy is expected to generate this year. For this reason, Irwin Kellner, chief economist for Manufacturers Hanover in NYC, predicts that long rates will rise to 9% by year end. If Kellner is right, I'd say that would be a surprise, wouldn't you?

You want more surprises? Try this: Ross Perot runs for president as an independent and scares the devil out of both parties. Will Perot get on the ballots of 50 states? Could Perot possibly win the election? Let me put it this way; the American people are fed up to their eyeballs with what we've got now. They're fed up with Congress, they're fed up with Bush, and they're hardly glassy-eyed over Bill ("scandal a week") Clinton. Perot is a man whose life has been a long series of amazing successes. Perot doesn't mince words, and he doesn't talk like a mealy-mouthed politician. America may finally be ready for someone who speaks the truth and acts on what he believes. It's going to be an interesting election year, count on it.

Meanwhile, we have an economic dilemma. I call it "Inflate or die (deflate)," that's the choice facing the US today. The Fed has already made it s decision, and the decision is -- INFLATE, inflate like mad. But we have a surprise in this area too. The surprise is that despite all the Fed's frantic inflationary actions, so far, deflation seems to be winning. Gold has been telling us that.

THE MARKET: I've reviewed the overvaluation aspects of this market in Letter after Letter. Believe me, on any historical comparison this market is vastly overvalued. The other side of the coin is that many US corporations have become "lean and mean."

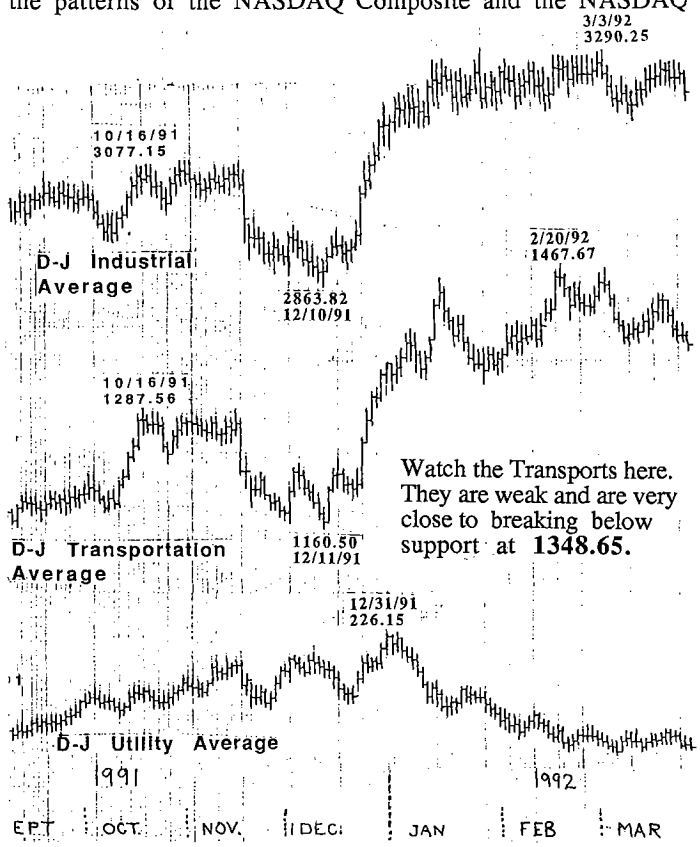
Mar. 20 DJIA 3275.71; PTI 3477; A-D Ratio -9.34
Mar. 27 DJIA 3231.44; PTI 3460; A-D Ratio -10.04
Dow Yield: 2.86%; Dow Price/Earnings: 57.2
Dow 200-day MA: 3068; Dow 30-day MA: 3250
Dow Times Book Value: 2.42; PTI 89-day MA: 3439
Percentage of Undervalued Blue-chips: 9%

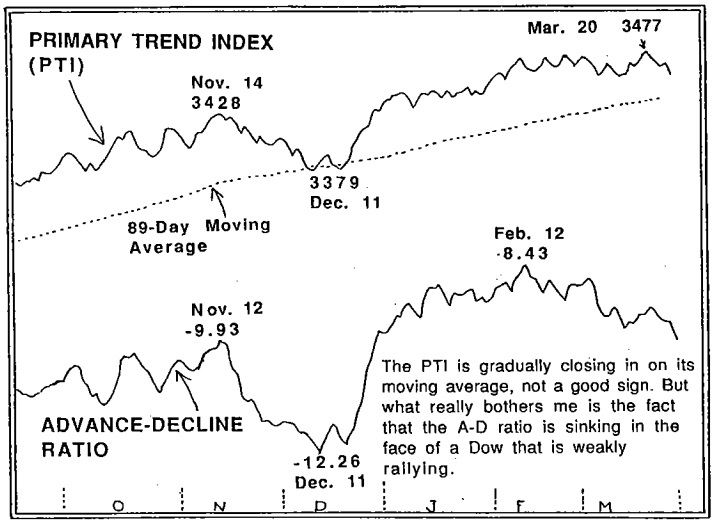
They've cut overhead, they've jettisoned divisions, and they've fired tens of thousands of unwanted workers, both blue and white collar. This action should make for higher profits later this year and next. But the current high valuations for stocks has already discounted higher profits. With the Dow yielding less than 3%, this market has fully discounted any "forthcoming boom."

The divergences in this market are disquieting. A few weeks ago the Dow hit a record high, and at the same time the broad NYSE Composite broke to a 1992 low (the NYSE Composite is down 4% on the year). Simultaneously, the advance-decline ratio (which is a good proxy for all the stocks on the NYSE) broke to a new 1992 low. Strange action.

But despite the weakness in the A-D ratio, the NYSE Composite, the S&P 500 and the Wilshire, my Primary Trend Index (PTI) on March 20 pushed to a new high for the bull market (see page 2 chart).

There are other discrepancies. *Market Logic* (800-442-9000) reports that over the last 30 days "an overwhelming 75%" of corporate insider transactions were on the sell side, and that kind of insider distribution is never a good omen. *Joe Granville* (800-876-LETTER) notes that a shocking 335 NYSE stocks are now within one point or less of their 52-week lows. Particularly ominous are the patterns of the NASDAQ Composite and the NASDAQ





Industrials. Both are up on stilt formations, and both have formed nasty "head and shoulder" tops. The pattern here suggests the possibility of a broad break in the over-the-counter market.

The Dow keeps rallying, bouncing within a few percentage points of its 1992 high (high was 3290.25). And my PTI is moving sideways, but holding close to its high for the year. Nevertheless, I don't get a good felling about this market. Despite the happy antics of the Dow, the general list acts "heavy," the Transports have been sliding, the Utility Average is just a few points off its low, and new stock issues are coming out at the frantic rate of $100 billion a year. Finally, in case you forgot, the broad NYSE Composite and the S&P 500 recorded their highs for the year back on January 15. They're down on the year.

The "sneaky" weakness in this market hasn't shown on my PTI yet, but the distance between the PTI and its 89-day moving average is narrowing. The action of the PTI over the next few weeks could tell the story. Caution, please.

CRITICAL PICTURE: From its high 38,915 set on December 28, 1989, Japan's Nikkei 225 stock index has lost roughly 50% of its value (two weeks ago it broke below 20,000). Japan's much broader Japanese Topix index (1,222 stocks) has lost considerably more than the Nikkei, and if the Nikkei were to match the loss in the Topix it would be down to around 18,000.

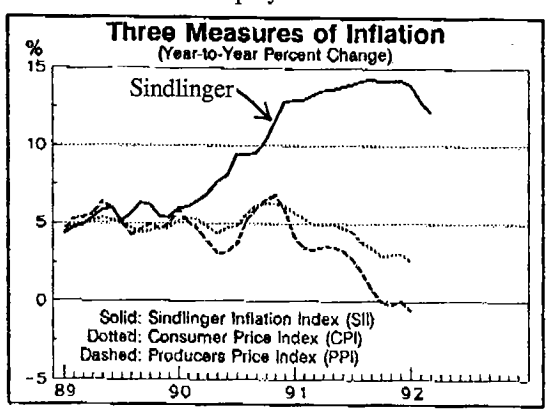
Big losses, yes, but it's the underlying meaning of the collapse in the Japanese market that interests me. Any time a major stock index or average loses half its value over a two-year period you're not talking about a correction, you're talking about a primary bear market. There's no question about it, the direction of the primary trend in the land of the rising sun is -- down.

But is Japan an isolated situation, an island of problems in an otherwise prosperous world? I find that hard to believe. As I wrote in the last Letter, primary movements (whether bull or bear) are almost always international in scope. The three major economies of the world today are the US, Germany, and Japan. The growth leader, the bellwether of the three, has been Japan. That being the case, I ask myself -- can Japan be in a primary bear market, and the US be in a bull market? It's hard to believe. Then I ask myself, since the Japanese stock market has been the leader on the upside for decades, is the Japanese market now leading on the downside? Ah, that's the trillion dollar (or trillion yen) question. And we should know the answer before this year is out.

INFLATION/DEFLATION: Yeah, I'm wrestling with a lot of unanswered questions. For instance, my astute friends at *Investor's Digest* down in Fort Lauderdale start their latest report as follows: *"This bull market is being propelled by the most accomodative monetary policy in the history of the Federal Reserve System."* You don't believe it? Listen, adjusted reserves in the banking system between January 8 and March 4 (latest figures) were up at a compounded annual rate of 39.6%. On top of that, the Fed has dropped the discount rate down to a low, low 3.5%. Then on February 18 the Fed lowered bank requirements on checking accounts from 12% to 10%, a move which will be effective in April. That will release around $8 billion for the banks to lend.

That's not all. Jim Grant (of the famed *Grant's Interest Rate Observer* out of NYC) notes that over the last 12 months the Fed (reversing its previous policy) has bought a whopping $26.7 billion of government securities. These securities are purchased in the open market. Bank reserves are created in the process, a process called "monetization of the debt." In effect, the Fed is financing Treasury borrowing with newly created money. The process is highly inflationary. States top economist Eric Heinemann of Ladenburg, Thalmann & Co., *"The Fed has already passed the flash point of inflation."*

In view of all the above, why isn't inflation heating up? Why isn't inflation booming? I have two answers for that: (1) The current, compounding $15 trillion in total US debt (private, corporate and public) is so massive that it amounts to a crushing deflationary force. The enormous amounts of money needed to carry this debt exert an increasingly deflationary pressure on the US economy. (2) Ready for this one -- the government reports are just plain wrong -- according to the *Sindlinger* report (*Sindlinger* does their own research) inflation from the consumer's standpoint is actually running around 12% (see chart by *Sindlinger*). *Sindlinger* claims that the government isn't measuring the items that really affect the consumer. Furthermore, *Sindlinger* states that the government's figures on unemployment are phoney. The government claimed that in February, 10.1 million Americans were unemployed. *Sindlinger* says the real number of unemployed is 13.9 million.

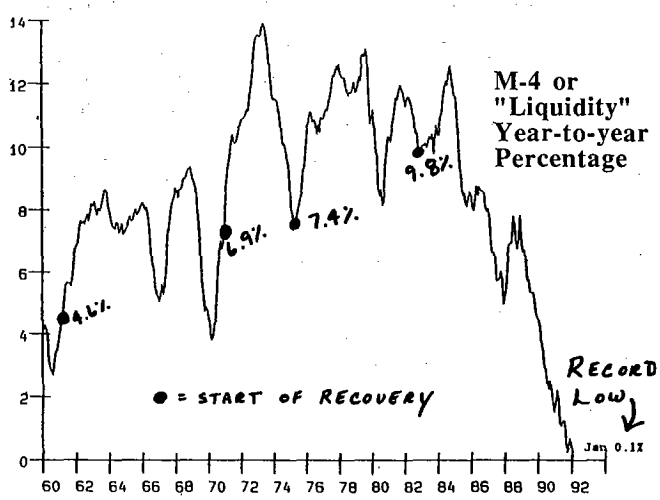


And here's what I'm thinking -- with all that the Fed has been doing, inflation "should be" running wild. Even the government's flawed "official" statistics should be indicating rampant inflation. But there's something else in the wind, and that something else is the deflationary pressure of debt.

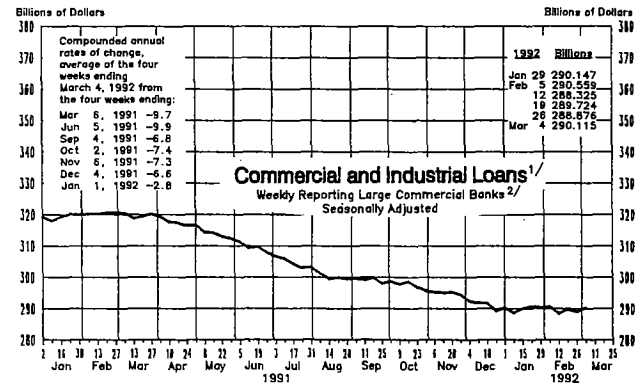
Commercial real estate, S&Ls and the banks have been the areas most obviously affected by deflation, although many other areas of the economy have suffered to a lesser degree. So the question is whether the Fed's frantic efforts at re-inflation are going to work, or whether the forces of deflation will prove too powerful, too much for the Fed to counteract.

One caveat: the Fed's re-inflationary actions usually don't "kick in" for a year or even up to two years. So we may not see the real results of the Fed's action until the end of 1992 or well into 1993.

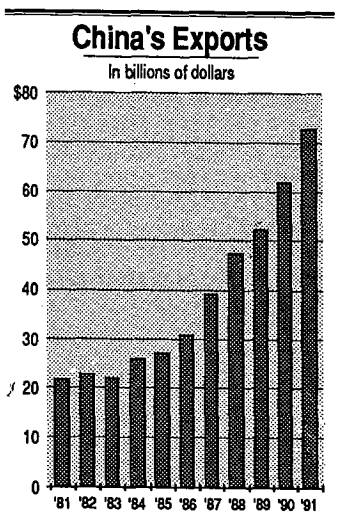
Money supply: Here we see Ed Hyman's (*International Strategy and Investment*) latest chart of the broadest measure of money supply, **M-4** or **liquidity.** The chart shows that on a year-to-year basis, M-4 hasn't gone anywhere; in fact M-4 is now only 0.1% above its level of a year ago. But here's the mystery -- at the beginning of previous recoveries, the average growth in M-4 was 7.2%. Question: today, with M-4 not growing at all, are we really in a recovery?



Loans: this year and next over $200 billion of commercial real estate loans come due. These loans must be renewed or refinanced. Many banks are more than a little queasy about renewing commercial real estate loans. In fact, as this chart from the latest issue of the St. Louis Federal Reserve Board shows, the banks don't want to make any loans in general (they'd rather buy safe Treasury paper). If the banks don't make the loans, there's going to be a lot of distressed commercial real estate for sale -- and a lot of bankruptcies.



INVESTMENT POSITION: Aside from massive overvaluation, the problem with buying US stocks now is (1) weak technical position of the market, and (2) competition -- from bonds. As US interest rates rise (and they are rising), this puts pressure on common stocks. As I've been saying in recent Letters, it's bonds (and, of course, interest rates) that are now the "policemen" of the nation.



The area that intrigues me now is Southern Asia and China. This is a quote from a service that I regard highly, *Street Smart Investing* (914-278-6500). "China's southern Guangdong Province, which borders on Hong Kong, will emerge as one of the great economic miracles of the 1990s. Consider that Hong Kong's trade with China jumped from $2 billion in 1978 to $50 billion in 1990. This area of China has produced real economic growth of 12% in the decade of the 1980s."

The giant wakes up, and the boom begins. As I've been saying, China is forsaking Marx and Lenin and Mao in favor of Adam Smith. The fact is that the strict old guard is losing out in China and the trend is now to capitalism, production, modernization, hard currency and exports. The big question in China today is not human rights but how fast China is willing to move towards "economic reform" (that's the Chinese euphemism for capitalism). China has set up special economic zones (almost all on the south coast) that are free trade and free market regions. So now, with the advent of information, computers, TV and extremely competitive wages, China is becoming a major economic force -- and fast. I think this chart (courtesy of *Investor's Business Daily*) confirms what I've been saying about China.

In view of this, I've recommended Hong Kong stocks. I bought Hang Seng Bank, Hong Kong Telecommunications, China Light & Power and Hong Kong Electric. This group, I feel, offers good participation in this booming area of the world. All of these are available over-the-counter as ADRs. Hong Kong Telecommunications is listed on the NYSE.

COMMODITIES: With the decline in interest rates and interest income, there is heightened interest in commodity trading, and I have received many letters from subscribers regarding commods.

So I want to say a few things about commodity trading. I receive five commodity chart services. I find that watching the trend of commodities is both instructive and fascinating. But I don't trade commods. Consistent profits trading stocks is difficult. Consistent profits trading commodities is EXTREMELY difficult.

Why? There is a basic difference in trading stocks and commods. Commodity trading is a zero-sum game. For every bull on a commodity contract, there must be a matching bear. In other words, for every winner there is also a loser. This is not true in stocks. If a stock goes up, theoretically no one has to lose (although in practice, there are usually some shorts on the stock, and those shorts will lose). So the fact that commodity trading is a zero-sum game makes it a tough game.

In actual practice, I have found that when one trades commodities you make a profit here, a small profit there, a small loss, and somewhere along the way you get hit with a "limit down," and that's where you take the bath. In a limit down you are usually locked into the commodity, and you are forced to take the full downside loss.

Finally, when trading commodities you do not have the safety of a dividend as you do with most stocks. For instance, if a good stock provides a well-covered dividend, there is usually a limit to how far it will go down. And if it continues down, at some point it will be a screaming buy based simply on its yield. Not so in commodities. Buying or selling a commodity is a strict speculation, it is never an investment because there is no return or dividend being offered. In other words, it is very difficult to think of a commodity as a "value" in the way that one can judge a stock as a value.

NOTES & QUOTES: If I had to chose between Bush and Clinton I'd chose Bush. Why? (1) I think Clinton is slimy. (2) I think of the two, Bush would do less harm. But wait, there's hope. **Ross Perot**, the tough-thinking, independent, self-made billionaire businessman is in the process of throwing his hat into the ring. In US history, when the nation was in trouble, somehow, almost miraculously, the nation produced the right man for the job. I think the US is in trouble. I think Perot is the right man for the job. Perot says it will cost $50 to $100 million to run a campaign, but that "we will do whatever it takes to run a good, first-class campaign". Referring to the fact that the federal debt was $1 billion when Reagan came in and it is now pushing $4 billion, Perot said, "Maybe it was voodoo economics. Whatever it was, we are in deep voodoo." Ross Perot has a long, dramatic history of getting things done and done right. He'd sure have my vote.

* *

Angry Voters See Perot Riding in Like Cavalry

■ **Campaign:** Texas billionaire strikes a chord with petitioners weary of the usual political roundup.

WHOOPS! I forgot to put the bull in the box, although he does still belong there. But I can explain, Lynn Hunter, my regular assistant, is a rabid baseball fan, and on Letter day she decided to rush off to Yuma to see the Padres play. So you see, it's not my fault, and. ... but . . . if. . etc.

In the 1940s the combined worker-employee Social Security tax was 2%. By 1973 it was 11.7%. Since then it has boomed to 15.3%. Seventy percent of American families and more than 50% of all American workers are now paying more in Social Security taxes than they are in income taxes. To me, that amounts to a gathering disaster. And as to the SS Trust, the government has borrowed it all -- to cover the deficit. Our kids are going to love what we've done.

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By mid-1991 the Federal Deposit Insurance Corp. was supposed to have around $23 billion on hand to pay off depositors in case of bank failures. But the sad story is that the FDIC only had $4.4 billion. Since then, the word is that the fund may be down below $3 billion, this despite the fact that FDIC premium costs to banks have tripled in the last two years. It looks as though the government will have to make up the losses, and you know who gets the bill in the end.

* *

One by one, the nation's insurance funds have been depleted. The Social Security Trust Fund was wiped out long ago (the money was used to help cover deficits) and now all that is left in the Trust is government IOUs. The Medicare Hospital Insurance Trust is being depleted, and despite the fact that the premiums were doubled last year, the fund will be wiped out by 2005. As for private insurance companies -- the word is that if anything, the private insurance companies may not be doing much better.

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Federal welfare expenditures in the US have reached their highest level in history -- roughly $140 billion in 1991. On top of that, state spending on welfare runs around $46 billion. In California (which spends 10% of the state's $55.7 billion budget on welfare), welfare has been growing at the rate of 12% a year (Governor Wilson finally put the brakes on).

In the last quarter century, the fastest growing segment of welfare has been single mothers under 18 and their children. Today 52% of all poor families are headed by single mothers. Among poor inner-city blacks, single parent families outnumber those with both parents three to one. Furthermore, 25% of all the children in the nation are now raised by a single parent. Under the current system, says one observer, "Welfare mothers are married to Uncle Sam. Uncle is the rival suitor for her hand." Russell comment: I guess you could call this the ultimate breakdown of the American family. What comes first, the poverty or the breakdown? I think they work in tandem, but one thing is for sure -- the whole breakdown is conducive to crime.

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An interesting quote from Goh Keng Swee, Chairman of the Singapore Monetary Authority and a top advisor to China: "The Chinese experience is totally different from the Russian experience. In the former Soviet Union, Gorbachev wanted *perestroika*, reform, plus *glasnost*, openness. The Chinese say *perestroika* first, *glasnost* later. And I think they are right. The Chinese system is still intact; the Soviet Union is gone. But the Chinese, unlike the Russians, have been experimenting with the market in their economy since 1979. They understood that the command economy is inefficient. So the reforms from 1979 firmly introduced market principles into the systems. Chinese don't look for 100% change; it's impossible. It is only by slow improvements over a wide range of industries and areas. They will be very successful, I think. In that instance, they are different from the Russians who want to have a big new system introduced overnight. It cannot be done."

Taiwan hates debt, loves gold, and knows how to produce (just check the number of "Made in Taiwan" labels at your local department store). At the end of January, deposits in Taiwan's legal banking system were a massive $300 billion, equal to $15,000 for every person in Taiwan. And deposits outside the legal banking system plus gold reserves could amount to another $300 billion. Last year Taiwan's foreign exchange (foreign currency plus gold) rose by $10 billion, giving the island over $82 billion in foreign reserves, the biggest hoard of any nation in the world. Maybe Washington should take lessons from Taiwan.

* *

Talk about insanity, try this for size. The US wants to shrink its armed forces, and the government is now offering pay incentives to leave. At the same time (can you believe this) the armed forces continue spending for recruiting, with ad agencies getting from $10 to $25 million to team up and place recruitment ads. The latest Defense Dept. figures show $122 million earmarked for recruiting. The US currently has 6,000 recruiting offices throughout the country employing 23,000 persons. As the teenagers say, "Gag me with a spoon."

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American companies are starting to hit the Chinese market. Avon has recruited more than 10,000 salesmen in China. Says George Gustin, an executive for Avon,based in Hong Kong, "Everything I see and feel and touch indicates that the rest of China is going to move in the same direction as the south."

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The *Christian Science Monitor* calls what is happening in Iraq today Genocide. "The suspicion was always there, among those who knew its murderous nature, that Saddam Hussein's regime had killed tens of thousands of Kurds, not simply as the unavoidable consequence of fighting Kurdish guerrillas, but deliberately, as a measure of extermination. Now the story is coming out in all its horror. Iraqi documents seized during the Kurdish uprising in March and April of last year -- enough to fill two trucks -- according to sources who have seen them -- tell of mass slayings of civilians. Kurdish sources say as many as 180,000 of their people were murdered by Iraqis."

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I guess you could say that each and every one of you loyal subscribers is worth more than Donald Trump. Or maybe this is the story -- it's not what you're worth, it's what you control. *Business Week* (March 23) offered a rundown on Donald Trump's assets and liabilities. Trump's assets total $1.116 billion. But he owes $2.495 billion. So his net worth is a minus $1.379 billion. Trump is over a billion dollars in the hole. Can he survive? Trump's fate, it seems to me, depends on the real estate market and the sentiment and good graces of the banks. Late note: Trump has given up 49% of the famed Plaza Hotel in return for easier financing. Trump paid $409 million for the Plaza, and valued it at the time at $830 million. But the new refinancing agreement values the Plaza at about $260 million.

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I often wonder how small businesses make it in this era of rising taxes and generally rising expenses. Here's how one restaurant owner describes his situation (from the *Washington Post Weekly,* Mar. 12): "Under the cover of running a restaurant, I am actually a tax collector for the US government: I collect Social Security, Medicare and federal income withholding taxes, sales, workers' compensation, unemployment and withholding taxes for the District of Columbia; and income withholding taxes for Maryland and Virginia. As the recession has drifted business down, the government continues to pile one payroll expense on top of another. . even now Congress is considering another massive cost-hike in the form of mandated health benefits."

* *

Boxing, football, which is the most dangerous sport? I just talke to my son-in-law, Vince Van Patten (he and his dad are ardent horse racing fans), and Vince tells me that horse racing is the most dangerous sport. He told me that over 50 ex-jockeys are now paraplegics, the result of disastrous horse falls. Can that be right? Can you believe it? If so, horse racing makes boxing and football seems like child's play.

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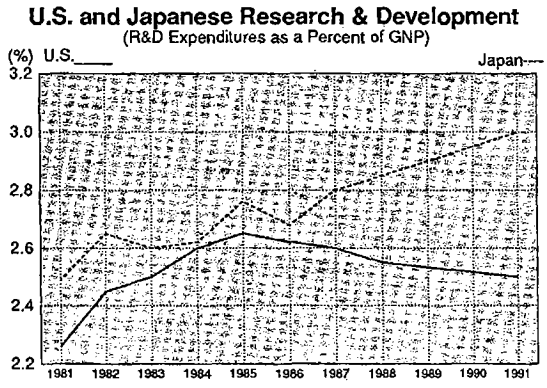
How about this: since 1985 US expenditures for research and development as a percentage of GNP have actually been declining. During the same period, Japanese expenditures for R & D have been steadily rising. This ominous chart from Merrill Lynch research tells the story. Currently, Japan is actually graduating more engineers than we are. Actually, there has been a general loss of interest in science on the part of Americans. Statistics show that from 1970 to the mid-80s the number of graduating college science majors in the US actually declined, despite a boom in the college population.



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Sign of the Times Dept. Under a recently negotiated bankruptcy plan, the common stock of Continental Airlines is worthless, kaput, finished. Yet for six weeks, over the company's vociferous objections, the stock was traded on the AMEX. And apparently unaware investors had been paying as much as $1.50 for the worthless paper. Continental has even refused to pay a $13,000 bill, a listing fee, to the AMEX in order to drive home the fact that the stock is worthless. Nothing stopped those "investors" until last week when the AMEX announced that trading would be halted.

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Boy, it's great to be successful. Barry Diller is the man who did the impossible, started a new network -- FOX. Diller shocked Hollywood by quitting in the middle of his super-successful undertaking. What's Barry going to do next? Whatever it is, the money is waiting to back him, big money. Said one Wall Street banker, "I could find $100 million tomorrow, no strings attached." Meanwhile, the rumors are flying, will he join up with Perelman, Geffen, no one, will he stay in Hollywood, will he take over a studio, will he get out of entertainment entirely? It's lovely to be loved.

* *

If you're a dictator, and your people have kicked you out, where do you go? The answer is France. Why does France offer a landing place for dictators? Well, France reasons that if you offer a dictator a home, he may be more inclined to get out of his own country and stop stealing and killing. Enjoying the Riviera today is the infamous Jean-Claude "Baby Doc" Duvalier, formerly of Haiti. Also on the Riviera General Michel Aoun, the Mad General of Lebanon. Probably coming soon -- President Mobutu Sese Seko of Zaire (he already has a house on Cap Martin). Another reason France welcomes dictators, these guys have money, piles of it, usually stolen from their state treasuries.

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High-profile cars, forget 'em. Today's high-prestige item is the Gulfstream jet. Tom Cruise has one. And Hollywood's David Geffen just bought one for $25 million. And as an extra added attraction, Geffen added a $600,000 satellite phone system to his Gulfstream. So there.

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Women's Wear Daily (the bible of the fashion trade) in its March 23 issue headlines the new Paris Fashions, and the headlines say, "Paris, Back to the Maxi." If you believe the hemline theory, this is bad news for Wall Street, which says that stocks follow womens' hemlines. The new hemlines are down to the ankles, at least that's what Paris is showing.

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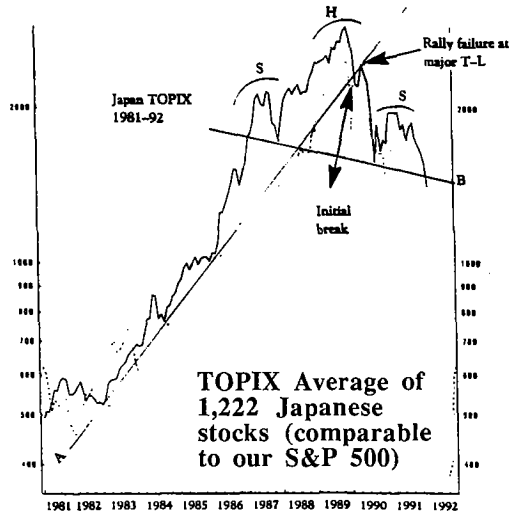
Here's a rare view of Japan's broad TOPIX index from 1981 to the present. This is a huge top, and it certainly suggests that Japan is in for even more trouble, since the TOPIX has just broken support at trendline B on the chart.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TOPIX Average of 1,222 Japanese stocks (comparable to our S&P 500)
1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992

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It's hard to believe, but the public is totally fixated on the shenanigans at the house bank and post office. In terms of the big fiscal picture, the Congressional check kiting doesn't have a bit of significance. It has to do with a couple of million dollars or less. Of course, the public is furious about the situation because it's symbolic, and it's something they can relate to.

The real problem is the out-of-control federal debt, but that involved tens of billions of dollars, and that's a much hazier concept.

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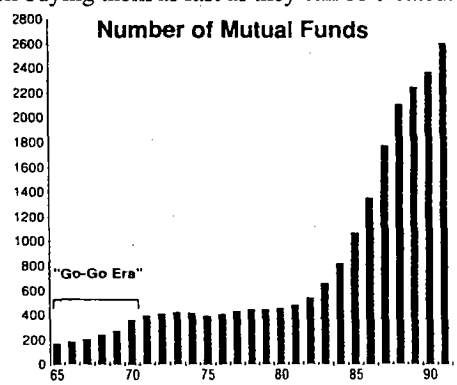
When I started writing *Dow Theory Letters* back in 1957, if anyone had shown me this chart I would have said they were out of their minds. Yet here we see the growth of mutual funds in the US. Of course, for the sponsors a fund is considered money in the bank. Think of a new name, bring in a few million to a few hundred million and you're off. The public is enamored of the funds, and they've been buying them as fast as they can be created.



Lately, even the closed-end funds have been getting a play. Traditionally, the closed-end funds have sold at a discount from net assets. I've followed some of the big closed-end funds such as Tri-Continental, General American Investors and Salomon Bros. Fund (formerly Lehman Fund) for decades. Recently, Tri-Continental actually sold at a premium over assets, something I've never seen before. I remember many years ago seeing Tri-Continental (the oldest of the closed-end funds) selling at a discount of over 40% from net assets. That, of course, was when the stock market was out of favor. Currently, it is my opinion that the stock market is "over-loved." The premium on Tri-Continental tells me that.

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As mentioned a few Letters ago, giant Olympia & York is in a bit of trouble. The trouble that has hit the Toronto-based firm has caused the Canadian government to take the extraordinary step of acting as broker in order to save the firm. Olympia & York's

troubles, in fact, have engulfed the entire Canadian banking system. Four big Canadian banks each have loans of more than $400 million to Olympia & York. The firm is also the biggest landlord in Manhattan, the owner of much real estate in Toronto's financial center and owner of the monster Canary Wharf, the $7 billion London enterprise. Mmm, Citicorp and Chemical Bank have each loaned Olympic & York a billion dollars. What's next ? -- divestment. O & Y is going to sell off some properties in order to raise cash and pare debt.

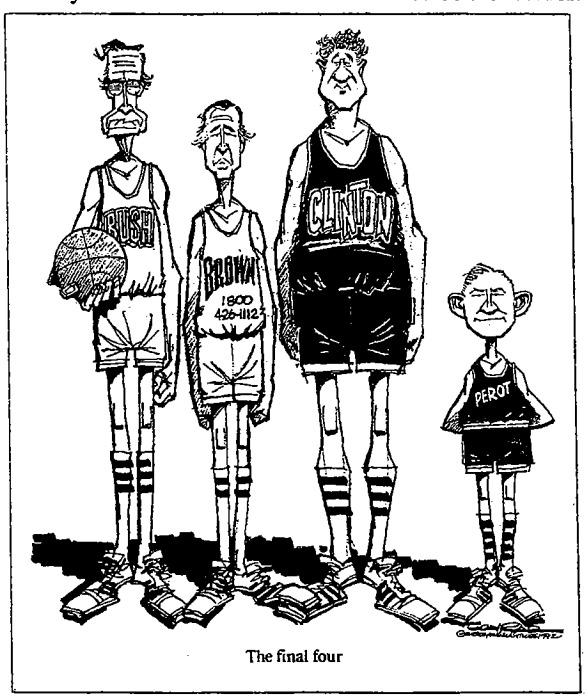
* *

You remember the "oohs" and "ahs" when Nippon Telephone and Telegraph first went public in Japan a few years ago? The public went wild for the issue, and the value the market put on this stock was insane. As I remember, the market valued it as worth more than the 30 stocks in the D-J Industrial Average. But times have changed. With the collapse of the Tokyo market, Nippon Tel. has lost 80% of its value and holders have taken a monumental beating.

On March 27 the Nikkei again fell below the critical 20,000 level, dropping to a new five-year low. I take the continuing primary bear market in Japan very seriously. In fact, I would say that the Japanese bear market is now starting to affect the world markets.

* *

No doubt about it, this has become one weird pre-election. Famed artist Conrad has captured the election atmosphere with all its goofiness in this cartoon. But c'mon, Ross Perot isn't a midget, he's five foot six. Conrad's got George Bush holding the ball. How long he can hang on to it is anyone's guess. My opinion: this may be the year when the stock market will decide the winner.



The final four

GOLD: One theory making the rounds is this: the German mark has been the bastion against inflation. People have been holding marks in lieu of gold. When German interest rates rise, so does the mark, while simultaneously the dollar goes down along with the dollar-price of gold. Conversely, when German rates decline, the mark declines while gold and the dollar go up. In other words, gold tends to rise and fall with the trend of German interest rates. A chart put out by Ed Hyman shows gold moving consistently counter to the trend of three-month German Euromark yields.

Another chart that particularly interests me is Ed Hyman's chart showing the percentage of the Fed's holding of total debt, almost all of which is Treasury debt. Note that since the mid-1970s the Fed's percentage of holding of debt was declining. But since 1990 this has changed. Since 1990 the Fed has been buying Treasury debt, and this "monetization" of the debt is highly inflationary. It's part of the Fed's all-out policy of re-inflation, and sooner or later it's going to "hit" in the economic statistics.

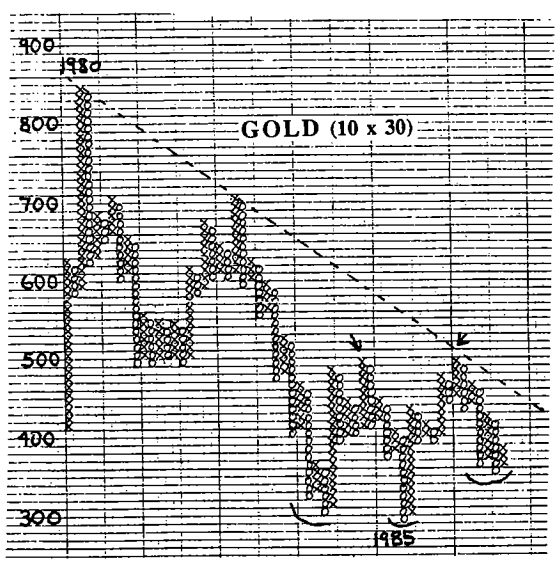
The drop in the price of gold has pressed the earnings of many gold mines into the loss column, and this is certainly true of the South African mines. On top of the drop in the gold prices, there is constant pressure to boost the wages of miners, and again this is particularly true of the African mines. Now, with the death of apartheid, we can expect an acceleration of African wage demands, and we can also expect many gold mines to close. This will put long-term pressure on gold production and in the end the supply/demand equation will favor higher gold prices.

Now consider this: in the next two years the US will be adding an unbelievable trillion dollars to its national debt. Figuring conservatively, this will mean an additional $40 billion in annual interest costs to the government. This year the government will pay just under $300 billion in interest costs. Add another $40 billion, and you're talking about INTEREST COSTS OF ROUGHLY A BILLION DOLLARS A DAY.

Question -- how will these massive debts be financed? Answer: the way they've always been answered -- via inflation. As I said, right now the Fed is buying up Treasury debt, and if this continues it will be very inflationary. I think it is only a matter of time before investors see the picture, and for this reason I suspect that gold is bottoming in this area.

Another thought, and I will go into this in a later Letter. The public and the institutions are now heavily in bonds, stocks, real estate (to their sorrow) and even cash. The one area that is hated and under-owned is the precious metals. It's worth thinking about.

Along those lines here's a most interesting point & figure chart that a subscriber just sent me. A case can be made for a huge "head & shoulders" bottom in gold. But first things first, and on the upside the first bullish target would be June gold futures hitting 360.



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